No. 94-967

In The

Supreme Court of the United States

October Term, 1994

WILLIAM FIELD AND NORINNE FIELD,

Petitioners,

vs.

PHILIP W. MANS,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The First Circuit

PETITIONERS' BRIEF

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QUESTION PRESENTED FOR REVIEW

Given that 11 U.S.C. § 523(a)(2)(A) requires proof that creditors rely on a debtor's fraudulent actions in order that a debt be excepted from discharge in Bankruptcy under 11 U.S.C. § 523(a)(2)(A), and given that the Bankruptcy Court has found fraud, and reliance by the creditor upon the debtor's misrepresentation, is it also necessary that the creditor prove that its reliance upon the fraudulent misrepresentation was reasonable?

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United States Court of Appeals for the First Circuit 94-1391 unpublished opinion dated August 29, 1994.

GROUNDS ON WHICH JURISDICTION OF THE UNITED STATES SUPREME COURT IS INVOKED

This is an appeal of the judgment entered August 29, 1994 by the United States Court of Appeals for the First Circuit, affirming the judgment of the United States District Court for the District of New Hampshire dated December 7, 1993, affirming the decision of the United States Bankruptcy Court dated May 11, 1993, finding the debt of the defendant to the plaintiffs to be dischargeable in Bankruptcy.

Certiorari was sought in accordance with 28 U.S.C. § 1254(1) and United States Supreme Court Rules Rule

10.1(a) and 10.1(c), by petition filed November 22, 1994. The deadline set by the Court for filing the Petition for Writ of Certiorari, in accordance with United States Supreme Court Rule 13.1 was November 26, 1994.

Certiorari was granted May 1, 1995. The deadline set by this Court for filing of the Appellants' Brief in accordance with United States Supreme Court Rule 25 is June 15, 1995.

CONSTITUTIONAL AND STATUTORY PROVISIONS

UNITED STATES CONSTITUTION ARTICLE I, SECTION 8:

The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States;

To borrow Money on the credit of the United States;

To regulate Commerce with Foreign Nations, and among the several States, and with the Indian Tribes;

To establish an uniform Rule of Naturalization, and uniform Laws on the subject to Bankruptcies throughout the United States; . . .

28 U.S.C. § 1254

Cases in the courts of appeals may be reviewed by the Supreme Court by the following methods:

(1) By writ of certiorari granted upon the petition of any party to any civil or criminal case, before or after rendition of judgment or decree;

(2) By certification at any time by a court of appeals of any question of law in any civil or criminal case as to which instructions are desired, and upon such certification the Supreme Court may give binding instructions or require the entire record to be sent up for decision of the entire matter in controversy.

11 U.S.C.A. § 523(a)(2)(A) (West 1994)

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual from any debt –

> (2) for money, property, or services, or an extension, renewal, or refinancing or credit, to the extent obtained, by –
>
> (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition; . . .

11 U.S.C.A. § 523(a)(2)(B) (West 1994)

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) or this title does not discharge an individual from any debt –

(2) for money, property, or services, or an extension, renewal, or refinancing of credit, to the extent obtained, by –

(B) use of a statement in writing –

(i) that is materially false;

(ii) respecting the debtor's or an insider's financial condition;

(iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied;

(iv) that the debtor caused to be made or published with intent to deceive; . . .

UNITED STATES SUPREME COURT RULES:

RULE 10 Considerations Governing Review on Writ of Certiorari

.1 A review on writ of certiorari is not a matter of right, but of judicial discretion. A petition for a writ of certiorari will be granted only when there are special and important reasons therefor. The following, while neither controlling nor fully measuring the Court's discretion, indicate the character of reasons that will be considered:

(a) When a United States court of appeals has rendered a decision in conflict with the decision of another United States court of appeals on the same matter; or has decided a federal question in a way in conflict with a state court of last resort; or has so far departed from the accepted and usual course of judicial proceedings, or

sanctioned such a departure by a lower court, as to call for an exercise of this Court's power of supervision.

. . .

(c) When a state court or a United States court of appeals has decided an important question of federal law which has not been, but should be, settled by this court, or has decided a federal question in a way that conflicts with applicable decisions of this Court.

. . .

STATEMENT OF THE CASE

In June, 1987 the plaintiffs, William and Norinne Field (Fields) sold real estate to an entity wholly owned by the defendant, Philip Mans (Mans), were paid approximately $275,000.00 cash and were given a promissory note in the amount of $187,500.00. The note was guaranteed by Mans, and was secured by a second mortgage on the property which was duly recorded at the Registry of Deeds. (The mortgage was junior to a mortgage to Mascoma Savings Bank.) (CP. 24).[1] The mortgage prohibited the defendant from conveying the property without the prior written consent of the plaintiffs, and further stated

[1] Throughout this document, citation format will be as follows: (CP ___) refers to petitioners' petition for Writ of Certiorari, and appendix thereto. (A ___) refers to the joint appendix to this brief. (R ___) refers to the transcript of the trial, May 11, 1993, 9:57 a.m. before Judge James E. Yacos, United States Bankruptcy Court for the District of New Hampshire.

that, on such a sale, the whole of the remaining indebtedness secured by the mortgage would, at the option of the holder of the mortgage, be immediately due and payable. (R.76). On or about October 8, 1987, in direct violation of these terms of the mortgage, Mans caused a transfer of title of the mortgaged property to a partnership known as Crescent Beach Development ("Crescent Beach"). (R.76).

The transfer, pursuant to the terms of the mortgage, triggered the due-on-sale clause, but the plaintiffs were unaware that the transfer had taken place. In fact, Mans had intentionally concealed the transfer in such a way as to defraud the plaintiffs, by sending a letter purportedly seeking permission for the transfer, AFTER the transfer was nearly complete. (R.77). Specifically, the letter, dated October 8, 1987, advised the Fields that Mans had taken on a partner in the development of the property. The letter further went on to say:

> Obviously we do not want to trigger the "due-on-sale" clause by reason of the transfer of the property into the development partnership. We ask that Mr. and Mrs. Field, as the holders of the second mortgage, consent in writing to the transfer of the property. (R.77).

The Fields responded by letter dated October 19, 1987. Among other conditions, they stated that they would approve the transfer if they received a payment of $10,000.00. (R.78). Mans, through counsel, responded on October 27, 1987 that "the fee of $10,000.00 is out of the question." However, Mans in this October 27, 1987 correspondence did not disclose to the Fields that the transfer had actually already taken place despite the lack of consent. (R.79).

The Fields, subsequent to the undisclosed transfer, continued to receive payments on the note through November, 1990. No further payments were forthcoming, and the Fields received notice of Mans' voluntary bankruptcy petition in December of 1990. The Mascoma Bank foreclosed on the property on or about June 7, 1991, recovering its first mortgage. No funds were available to satisfy the Fields' second mortgage. (R.81).

The Fields filed a non-dischargeability complaint against Mans in the Bankruptcy Court under the provisions of § 523(a)(2)(A) arguing that they were "duped" into extending credit (the promissory note) beyond its time period (option to call upon subsequent transfer) by Mans' fraud in obscuring the fact that he had transferred the property. Federal Court jurisdiction over this matter was grounded on Article I of the United States Constitution, and Title 11 of the United States Code. After trial, the Bankruptcy Court found that in fact an extension of credit was proven, that misrepresentations had taken place and that reliance was proven, but that the plaintiffs failed to prove that their reliance on the fraud was reasonable.

Since the Bankruptcy Court explicitly found that the debtor committed fraud, and that the creditor relied upon that fraud, and since those findings have been upheld by the United States District Court for the District of New Hampshire and the First Circuit Court of Appeals, the only issue on appeal to this Court is whether or not the creditors were required to prove, under § 523(a)(2)(A)

that their reliance upon the debtor's misrepresentations was reasonable.

SUMMARY OF THE ARGUMENT

The plain language of 11 U.S.C. § 523(a)(2)(A) does not require that a creditor's reliance on a debtor's fraud be reasonable. By contrast 11 U.S.C § 523(a)(2)(B) has such a requirement. The Congressional history explains why "reasonable reliance" is in the latter section but not the former; Congress was seeking to prevent creditors who might induce fraud from benefiting from their collusion in creating the fraud.

Nonetheless, a split has developed amongst the circuit courts of appeals on whether to include a requirement of reasonableness of reliance in § 523(a)(2)(A) cases. The more compelling argument is found in those decisions not requiring reasonableness of reliance. These decisions fairly balance an honest debtor's right to a fresh start, a core purpose of the Bankruptcy Code, with protecting creditors from the fraud of dishonest debtors.

The elements of common law fraud or misrepresentation contain sufficient safeguards to prevent creditors from relying on obviously false or absurd representations.

In the instant case while all the elements of non-dischargeability were found in the lower courts, those courts erroneously found the disputed debts dischargeable because they required proof of reasonable reliance.

ARGUMENT

I. THE PLAIN LANGUAGE OF 11 U.S.C. § 523(a)(2)(A) DOES NOT REQUIRE THAT A CREDITOR'S RELIANCE ON THE FRAUD OF A DEBTOR BE REASONABLE.

"When interpreting a statute, the starting point is, of course, the language of the statute itself. If the language is clear and unambiguous, and there is no clearly expressed legislative intent to the contrary, that language must ordinarily be regarded as conclusive." *American Tobacco Co. v. Patterson*, 456 U.S. 63, 68 (1982) and *Consumer Product Safety Commission v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980).

11 U.S.C. § 523(a)(2)(A) governs the dischargeability of the debt in the instant case. § 523(a)(2)(A) sets out the following elements of a non-dischargeability claim for fraud:

> 1. The debt must be for money, property, services, or an extension, renewal or refinancing of credit.
>
> 2. Obtained by false pretenses, a false representation, or actual fraud, **other than a statement respecting the debtor's or an insider's financial condition.** (emphasis added). (The full text of § 523(a)(2)(A) and § 523(a)(2)(B) is set out at petitioners' Petition for Writ of Certiorari, pages xi and xii.)

The language of § 523(a)(2)(A) is clear and unambiguous. There is no additional requirement that the creditor's reliance on the fraud be "reasonable". By contrast 11 U.S.C. § 523(a)(2)(B) specifically requires that creditors seeking non-dischargeability of debts under that section

prove their reliance was reasonable. Since the plain language of the statute excludes § 523(a)(2)(A) debts from § 523(a)(2)(B), by removing the class of debts created by a statement respecting a debtor's or insider's financial condition and creating § 523(a)(2)(B) to **only** include such debts, the element of reasonable reliance contained in § 523(a)(2)(B) applies only to non-dischargeability claims brought under that section.

Not only does the plain language of this statute exclude § 523(a)(2)(A) debts from § 523(a)(2)(B), but review of the Congressional history of these sections indicates that the sections were meant to be mutually exclusive.[2] Where the clear language of the statute and the Congressional intent are completely in harmony, the conclusion is that the reasonable reliance element applies only to claims of non-dischargeability brought under § 523(a)(2)(B). Because the debt in the instant case does not fall under § 523(a)(2)(B) but falls under § 523(a)(2)(A), the creditors' reliance on the fraud of the debtor need not be proven reasonable for the debt to be found non-dischargeable. "Finding the statute clear on its face and having no reason to think that Congress meant anything other than what it said, we can only conclude that § 523(a)(2)(A) does not require a creditor to prove that his

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[2] 124 Cong. Rec. H 11,095-6 (Daily Ed. Sept. 28, 1978); S 17, 412-13 (Daily Ed. Oct. 6, 1978). "Subparagraph A is intended to codify current case law e.g. *Neal v. Clark*, 95 U.S. 704 (24 L.Ed. 586) (1887), which interprets 'fraud' to mean actual or positive fraud rather than fraud implied in law. Subparagraph A is mutually exclusive from subparagraph B. Subparagraph B pertains to the so-called false financial statement". 124 Cong. Rec. S 17412 (Daily Ed. Oct. 6, 1978) (remarks of Senator DeConcini).

reliance on the debtor's fraudulent misrepresentations was reasonable". *IN RE: Ophaug*, 827 F.2d 340 (8th Cir. 1987) at 343.

II. THE LEGISLATIVE HISTORY OF § 523(a)(2)(A) AND § 523(a)(2)(B) AND THEIR PREDECESSOR STATUTE SHOW NOT ONLY AN INTENT THAT THESE SECTIONS BE MUTUALLY EXCLUSIVE, BUT SHOW A SUBSTANTIVE REASON BEHIND APPLYING A HIGHER STANDARD OF RELIANCE IN § 523(a)(2)(B) CASES.

The predecessor statute to § 523(a)(2) is former 11 U.S.C. § 35(a)2. The language of the former statute did not contain a requirement that reliance upon the debtor's fraud be reasonable. *IN RE: Ophaug*, 827 F.2d 340 (8th Cir. 1987) at 342.[3]

The term reasonable reliance as applied to non-dischargeability first appears in the modification of the predecessor act in the Bankruptcy Reform Act of 1978, 95 Stat. 2549 (1978).

The legislative history of the modifications reflects not only an intent to make separate provision for written financial statements under § 523(a)(2)(B), but also makes clear the reasoning behind applying a separate standard of reliance from the types of debts whose dischargeability were governed by § 523(a)(2)(A). *Ophaug*, at 342, 343, *In*

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[3] The case law under the former section likewise did not require reasonable reliance. *Id.*, citing *IN RE: Houtman*, 568 F.2d 651, 655 (9th Cir. 1978). However, the predecessor statute did not make separate provision for false or fraudulent written financial statements, as does the present version.

the Matter of Mayer, 1995 WL 193188 (7th Cir. Ill.). The concern was that creditors might induce debtors to falsify financial statements in order to make a debt non-dischargeable. Congress therefore explicitly required that non-dischargeability claims brought under § 523(a)(2)(B) be premised upon a showing of reasonable reliance by the creditor. *Ophaug*, at 342, 343, citing HR. Rep. No. 595, 95th Cong., 1st Sess. 130-31 (1977) U.S. Code Cong. and Administrative News 1978, P. 5787.[4] The amended section

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[4] "Current law provides a nearly identical exception to discharge. The differences are that current law does not cover a debt for services, and requires only reliance, not reasonable reliance, by the creditor on the statement. . . . The premise of the exception to discharge is that a creditor that extended credit based on misinformation or fraudulent information transmitted by the debtor should be protected. The provision, however, has led to abuse in consumer cases, and has frustrated the fresh start goal of the bankruptcy discharge.

It is a frequent practice for consumer finance companies to take a list from each loan applicant of other loans or debts that the applicant has outstanding. While the consumer finance companies use these statements in evaluating the credit risk, very often the statements are used as a basis for a false financial statement exception to discharge. The forms that the applicant fills out often have too little space for a complete list of debts. Frequently, a loan applicant is instructed by a loan officer to list only a few or only the most important of his debts. Then, at the bottom of the form, the phrase "I have no other debts" is either printed on the form, or the applicant is instructed to write the phrase in his own handwriting. In addition, the form states that the creditor has relied on the statement in granting the loan.

thus prevented creditors from essentially participating in the fraudulent act of the debtor (by closing their eyes to fraud at the time the debt is created) by discharging those debts upon which the creditor's reliance was not reasonable, while allowing those honest creditors who make sufficient inquiry (whose reliance is reasonable) to prevent discharge of the debts owed them. *Id*. See also *IN RE: Fosco*, 14 B.R. 918 (1981) at 918. "The requirement of reasonable reliance under § 523(a)(2)(B) makes abusive practices of this type less likely to succeed." *Id*.

However, the creditor often has other sources of information, such as credit bureau reports, to verify the accuracy of the list of debts. Nevertheless, if the debtor files bankruptcy, creditors with these financial statements are in a position to threaten the debtor with litigation to determine the dischargeability of the debt, based on the false financial statement exception to discharge. Most often, there has been no intent to deceive on the part of the debtor, and, as in so many aspects of the creditor-debtor relationship, the debtor has simply followed the creditor's instructions with little understanding of the consequences of his action.

Creditor practices in this area have been so strong that the Bankruptcy Commission recommended that the false financial statement exception to discharge be eliminated for consumer debts. This bill recognizes, however, that there are actual instances of consumer fraud, and that creditors should be protected from fraudulent debtors. It retains the exception, with small modifications. But it also recognizes that the leverage creditors have over their debts comes not so much at the stage when the loan application is made, but rather when bankruptcy ensues." *HOUSE REPORT 595, 95TH CONGRESS, 1ST SESSION, PGS. 130-131.*

Subsequent to the changes contained in the 1978 Act, some courts began to require reliance to be "reasonable" in non-dischargeability claims brought under § 523(a)(2)(A) as well as those brought under § 523(a)(2)(B), despite the clear language of the statute.[5]

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[5] See 97 ALR Fed. 402 for analysis.

Circuit Courts of Appeals:

IN RE: Burgess, 955 F.2d 134 (1st Cir. 1992)
Philips v. Coman, 804 F.2d 930 (6th Cir., 1986)
IN RE: Mullet, 817 F.2d 677 (10th Cir. Colo. 1987)
"Justifiable" rather than "reasonable" reliance required:
IN RE: Kursh, 973 F.2d 1454 (9th Cir. 1992)

District Courts:

IN RE: Hunt, 30 B.R. 425 (M.D. Tenn. 1983)
IN RE: McIntyre, 64 B.R. 27 (D.N.H. 1986)
IN RE: Michel, 74 B.R. 88 (N.D.Ohio 1985)
Title Ins. Corp. v. Pitt., 157 B.R. 585 (E.D. Va. 1991)

Bankruptcy Courts:

IN RE: Paolino, 89 B.R. 453 (B.C. E.D. Pa. 1988)
IN RE: Wise, 6 B.R. 867 (B.C. M.D. Fla. 1980) (discussing § 523(a)(2) in general)
IN RE: Ashley, 5 B.R. 262 (B.C. E.D. Tenn. 1980)
Bonosky v. Allen, 25 B.R. 566 (B.C. S.D. Ohio 1982)
IN RE: Constantino, 72 B.R. 231 (B.C. N.D. Ohio 1987) later proceeding 80 B.R. 865
IN RE: Cheh, 96 B.R. 781 (B.C. N.D. Ohio 1988)
IN RE: Cicero, 28 B.R. 480 (B.C. E.D. Wis. 1983)
IN RE: Guy, 101 B.R. 961 (B.C. N.D. Ind. 1988)
IN RE: Younesi, 34 B.R. 828 (B.C. C.D. Cal. 1983)
IN RE: Howarter, 95 B.R. 180 (B.C. S.D. Cal. 1989)
IN RE: Brewood, 15 B.R. 211 (B.C. D.C. Kan. 1981) (disapproved on other grounds by *Birmingham Trust Nat. Bank v. Case*, 755 F.2d 1474 (11th Cir. Ala. 1985))
IN RE: Maranzino, 67 B.R. 394 (B.C. D.C. Kan. 1986)
IN RE: Anzman, 73 B.R. 156 (B.C. D.C. Colo. 1986)
IN RE: Gering, 69 B.R. 686 (B.C. D.C. Kan. 1987)

Other courts, specifically the Eighth Circuit, Seventh Circuit and the Fifth Circuit, as well as other lower courts, do not require reasonable reliance.[6]

The analysis used by those courts requiring proof of reasonable reliance as an element in § 523(a)(2)(A) cases

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IN RE: Beleau, 35 B.R. 259 (B.C. D. R.I. 1983)
IN RE: Salvatore, 46 B.R. 247 (B.C. D. R.I. 1984)
Matter of Eaton, 41 B.R. 800 (B.C. E.D. Wis. 1984)
Matter of Weinstein, 31 B.R. 804 (B.C. E.D. N.Y. 1983)
IN RE: Gonzalez Seijo, 76 B.R. 11 (B.C. D. P.R. 1987)
IN RE: Waning, 120 B.R. 607 (B.C. D. Me. 1990)
IN RE: Sestito, 136 B.R. 602 (B.C. D. Mass. 1992)
Matter of Haining, 119 B.R. 460 (B.C. D. Del. 1990)
U.S. v. Spicer, 155 B.R. 795 (B.C. D.C. Dist. Col. 1993)
ITT Fin. Servs. v. Schoenlein, 157 B.R. 824 (B.C. N.D. Ohio 1993)
First Bank Sys., N.A. v. Foley, 156 B.R. 645 (B.C. D.C. N.D. 1993)

[6]

Circuit Courts of Appeals:

IN RE: Ophaug, 827 F.2d 340 (8th Cir. 1987) 97 ALR Fed. 395
Matter of Allison, 960 F.2d 481 (5th Cir. 1992)
In the Matter of Mayer, 1995 WL 139188 (7th Cir. Ill.)

Bankruptcy Courts:

IN RE: Showalter, 86 B.R. 877 (B.C. W.D. Va. 1988)
IN RE: Hamm, 92 B.R. 386 (B.C. W.D. Mo. 1989)
IN RE: Kroh, 88 B.R. 972 (B.C. W.D. Mo. 1988)
IN RE: Stewart, 91 B.R. 489 (B.C. S.D. Iowa 1988)
IN RE: Fosco, 14 B.R. 918 (B.C. D.C. Conn. 1981)
IN RE: Sobel, 37 B.R. 780 (B.C. E.D. N.Y. 1984)
IN RE: Monahan, 125 B.R. 697 (B.C. D. R.I. 1991)
IN RE: Schwartz and Meyers, 130 B.R. 416 (B.C. S.D. N.Y. 1991)
IN RE: McDermott, 139 B.R. 50 (B.C. D. R.I. 1992)

is not persuasive. In *IN RE: Burgess*, the First Circuit, without any detailed analysis of § 523(a)(2)(A) merely states that the creditor was required to prove " . . . (3) the creditor actually relied on the misrepresentation, and (4) the creditor's reliance was reasonable under the circumstances." *IN RE: Burgess*, 955 F.2d 134, 140 (1st Cir. 1992). The Sixth Circuit in *IN RE: Philips*, 804 F.2d 930 (6th Cir. 1986) relied on *IN RE: Martin*, 761 F.2d 1163 (6th Cir. 1985) to conclude that § 523(a)(2)(A) cases require reasonable reliance, but the *Philips* court admitted that *Martin* dealt with a § 523(a)(2)(B) discharge. "Although *Martin* deals with § 523(a)(2)(B), we believe these principles apply with equal force to § 523(a)(2)(A)." *Philips*, at 933.

The more persuasive view is that reasonable reliance is not required in non-dischargeability actions under § 523(a)(2)(A). A compelling argument for this position is the reasoning contained in *IN RE: Ophaug*, 827 F.2d 340 (8th Cir. 1987) and *In the Matter of Mayer*, 1995 WL 139188 (7th Cir. Ill.). In *Ophaug* the debtors had fraudulently obtained a loan from creditors, purportedly to purchase farm land. After securing a state court judgment, the creditors' judgment was discharged when the Bankruptcy Court concluded that the creditors' reliance on the misrepresentations of the debtor was unreasonable. *Id.* at 398.

In reversing the District Court's affirmance of the Bankruptcy Court, the Eighth Circuit Court of Appeals embarked on a thorough review of the statutory language of § 523(a)(2)(A) and § 523(a)(2)(B), as well as a review of the clearly established Congressional intent behind these sections. *Id.* at 342, 343. The Eighth Circuit concluded that

§ 523(a)(2)(A) contained no requirement of reasonableness of a creditor's reliance. *Id.* 343. "Finding the statute clear on its face and having no reason to think that Congress meant anything other than what it said, we can only conclude that § 523(a)(2)(A) does not require a creditor to prove that his reliance on the debtor's fraud was reasonable." *Id.*

In this case, as in *Ophaug*, the creditors' action was brought under § 523(a)(2)(A) which does not require that the creditors' reliance be reasonable.

In *Mayer*, the Seventh Circuit addressed the question of "whether a liar may obtain a discharge in bankruptcy by showing that the victim did not do enough to nose out the truth." *Mayer* at 1. The short answer the court supplied was: "Debts attributable to fraud may not be discharged, 11 U.S.C. § 523(a)(2)(A) and intentional deceit concerning a material proposition is fraud whether or not a more alert target would have smelled a rat." *Id.*

Mayer involved two transactions. the first where the debtors acted as "fronts" to secure loans for less creditworthy friends, and the second where the debtor fabricated a purchase order as proof of income to induce a lender to lend him funds. In neither instance was the creditor paid.

The Seventh Circuit Court of Appeals found the debtor in both instances had made material misrepresentations, on which the creditors had relied. *Id.* at 6, 7. In excepting the debts from discharge the court stated "fraud is an intentional tort, and victims need not take precautions against such torts in order to preserve their rights." *Id.* at 5.

The Court, as in *Ophaug*, looked to the intent of Congress in enacting § 523(a)(2)(A), to determine whether or not Congress had intended that a "reasonableness" element be included. It was noted that Congress had specifically provided for a "reasonable" element in § 523(a)(2)(B), but had not in § 523(a)(2)(A). *Id.*, at 4. "Congress deliberately distinguished the criteria for discharge according to the kind of document in which the falsehood appears" *Id.* The court also cited Prosser and Keeton on Torts, as well as the Restatement (2d) of Torts, as authority that "contributory negligence is not a defense to an intentional tort," *Id.* at 5. The plaintiff simply had no duty to investigate the truth of the defendant's statements. *Id.*

The holdings in *Ophaug* and *Mayer* are consistent with the purpose of the Bankruptcy Code. This Court has held that the central purpose of the Bankruptcy Code is to provide a procedure by which certain insolvent debtors can reorder their affairs, make peace with their creditors, and enjoy "a new opportunity in life and a clear field for further effort, unhampered by the pressure and discouragement of pre-existing debt." *Grogan et al. v. Garner*, 498 U.S. 279 (1991) quoting *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934). However, this opportunity for a completely unencumbered new beginning is limited to the "honest but unfortunate debtor". *Grogan*, at 287. This requires a balance between the conflicting interests of the debtor's "fresh start" and the creditor's right to recover debts which Congress excepted from discharge. In determining the standard of proof required in determining dischargeability of debts in § 523(a)(2)(A) cases, this Court found that "we think it unlikely that Congress, in

fashioning the standard of proof that governs the applicability of these provisions, would have favored the interest in giving perpetrators of fraud a fresh start over the interest in protecting victims of fraud". *Id.* It is respectfully submitted that this Court should be equally reluctant to rule that Congress would favor the interests of the perpetrator of fraud over the victim of fraud by requiring reasonable reliance in § 523(a)(2)(A) cases absent express Congressional intent that such standard be applied.

III. THE ELEMENTS OF COMMON LAW FRAUD OR MISREPRESENTATION CONTAIN SUFFICIENT SAFEGUARDS TO PREVENT CREDITORS FROM RELYING ON OBVIOUSLY FALSE OR ABSURD REPRESENTATIONS.

Holding that reasonable reliance is not a required element of a non-dischargeability claim under § 523(a)(2)(A) will not open the door to patently unsupportable complaints of creditors. This concern has been addressed in the case of *IN RE: Fosco*, 14 B.R. 918 (B.C. D.C. Conn. 1981). The *Fosco* court reasoned that "When misrepresentation is so apparent that the plaintiff's conduct cannot be said to have been motivated by any reliance the recovery is barred where reliance is an ingredient of proof in the plaintiff's case." Any action based on fraud requires proof of the element of reliance to show a material nexus between the fraudulent act of the perpetrator and the harm to the victim, however, the common law of fraud does not have any reasonable investigation requirement. *In the Matter of Mayer*, 1995 WL 139188 at 5 (7th Cir. Ill., March 31, 1995). The Restatement of Torts, 2d, § 540 also states that reliance on a

misrepresentation must only be justifiable. Justifiable reliance does *not* require that the recipient of misrepresentation investigate the underlying assertion. *Id.* The recipient is justified in relying on its truth. *Id.* Only if the representation is known by the recipient to be false, or if its falsity is obvious, is reliance upon the assertion *not* justified. *Id.*, at § 541[7]

> "The plaintiff's conduct must not be so utterly unreasonable in the light of the information open to him, that the law may properly say that his loss is his own responsibility." William L. Prosser, *Law of Torts*, § 108 p. 715, (4th Edition 1971).

The findings of the Bankruptcy Court in the instant case criticized the creditor for failing to investigate.

> "A party is not entitled to, you, know, be in good faith and just not objectively (sic) reasonable. . . . case law establishes an objective test, and that is what would be reasonable for a prudent man to do under the circumstances." (R.84).

The Bankruptcy Court went on to add that the creditor should have undertaken certain investigations, including researching the Registry of Deeds. *Id.*

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[7] § 540 provides the following illustration of the lack of any duty of investigation by one who relies on misrepresentation:

> 1. A, seeking to sell land to B, tells B that the land is free from all encumbrances. By walking across the street to the office of the Registry of Deeds in the Courthouse, B could easily learn that there is on record an unsatisfied mortgage on the land. B does not do so and buys the land in reliance upon A's misrepresentation. His reliance is justifiable. Restatement (2d) of Torts, § 540 at 88.

As the above authorities demonstrate, application of this standard of "the reasonably prudent man" and the duty to investigate is *contrary* to the elements of common law misrepresentation. Therefore, the Bankruptcy Court held the creditor in this case to an incorrect standard. It is noteworthy that the Bankruptcy Court in ruling that the creditor should have researched the Registry of Deeds, runs directly contrary to the illustration of justifiable reliance contained in Section 540 of the Restatement of Torts (2d). Such investigation is *not* required. See footnote 7.

IV. IN THE INSTANT CASE, THE FIRST CIRCUIT'S RULING THAT REASONABLE RELIANCE IS REQUIRED FOR NON-DISCHARGEABILITY OF DEBTS IN § 523(a)(2)(A) CASES WAS ERRONEOUS. SINCE THE PETITIONERS PROVED ALL OTHER ELEMENTS, AND ALL NECESSARY ELEMENTS FOR NON-DISCHARGEABILITY UNDER § 523(a)(2)(A), THE CIRCUIT COURT'S DECISION MUST BE REVERSED.

The Bankruptcy Court in the instant case found that the debtor in this matter had made implicit misrepresentations to the creditors.

> "All right. I'm going to find that there was a misrepresentation by you and your attorney in sending letters to Mr. Field that clearly implied that it (the property) had not yet been transferred." (R.68).

Additionally, the Bankruptcy Court found that the petitioner did rely upon the fraudulent representation of the

debtor, and that this reliance resulted in harm to the petitioner.

> "The evidence clearly establishes that the Fields relied on the implicit misrepresentations in these letters that the property had not yet been transferred. It's also established that they relied on this . . . to their detriment, in that at the time of October, 1987 the real estate market was still booming in this State." (R.80, 81).

The debt was ultimately deemed dischargeable, however, because the petitioners' reliance was found not to be reasonable. *Id.* at 81. Since all of the necessary elements for non-dischargeability were found by the Bankruptcy Court, and only the unnecessary element of the reasonableness of the petitioners' reliance was decided against the petitioners, the Court of Appeals' decision affirming the District Court's and thus the Bankruptcy Court's decision should be reversed. " . . . The debtor whose conduct is fraudulent under § 523(a)(2)(A) should not be discharged from his fraudulent debt when his victim's conduct was merely less than prudent." *IN RE: Fosco,* 14 B.R. 921, 923 (B.C. D.C. Conn. 1981).

CONCLUSION

For the foregoing reasons, the petitioners request that the judgment of the Court of Appeals be reversed, and the case remanded for entry of judgment in the petitioners' favor on the claims under § 523(a)(2)(A) of the Bankruptcy Code.

Respectfully submitted,

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